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No. 541

In the Supreme Court of the United States

OCTOBER TERM, 1932

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

A. T. JERGINS TRUST

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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v.

A. T. JERGINS TRUST

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The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit, entered in this case on September 8, 1932.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 96–124) is reported in 22 B. T. A. 551. The opinion of the Circuit Court of Appeals (R. 183) has not yet been reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered September 8, 1932. (R. 191.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. May the United States impose a tax upon income of a private association derived from the sale of oil and gas produced under an oil and gas lease of land owned by the city of Long Beach, California, the land having been acquired by the city, together with other lands, for the purpose of furnishing water to its inhabitants, and having been temporarily leased to the taxpayer, subject to termination on short notice and subject to the right of the city to use the property for water purposes?

2. In determining net income under the Revenue Act of 1921, may capitalized expenses for drilling and developing oil wells be deducted from gross income as depletion allowance?

STATUTES INVOLVED

These are set forth in the Appendix, *infra*, p. 8.

STATEMENT

The findings of fact made by the Board of Tax Appeals (R. 98–115) may be summarized as follows:

The taxpayer, an association organized in 1922 under the laws of California, was created for the purpose of entering into an oil and gas lease with the city of Long Beach, California, a municipal corporation. That city was authorized by its charter to own a water system and to purchase, hold, lease, and enjoy property of every kind and to control and to dispose of the same for the common good. (R. 98.)

Prior to 1911 the city obtained its water supply from two or more independent water companies. (R. 98.) The service being unsatisfactory and inadequate, the city acquired the equipment and mains of these companies, including 600 acres of land. Portions of this land not immediately required in connection with its municipal water plant were used by two oil and gas lessees (one of which is the respondent), and by about 60 tenants holding under leases or permits from the city. (R. 99.)

The business of these tenants included airplane repair, hangars for aircraft, oil-well supplies, telephone, storage plants, cracking plants, oil-skimming plants, dehydration plants, gasoline absorption plants, and farming. The leases were of a temporary nature, could be terminated on short notice, and were made subject to the right of the city to use the property for water purposes.

In 1922 the city, as lessor, and the respondent, as lessee, entered into an oil lease on about 140 acres of the 600-acre tract. (R. 100.) By the terms of

this lease the city was to receive forty per centum of the oil and gas produced, payable in kind or in money. (R. 107.) There was no finding by the Board of Tax Appeals as to the use made by the city of the receipts under this lease.

In 1922 all of respondent's gross income was derived from oil and gas produced under the lease. In 1923 $985,790.34 was so derived, and in 1924 $1,935,376.82. (R. 109–110.) The Board of Tax Appeals held that the United States could tax that income, and sustained the Commissioner's determination to that extent. (R. 118.)

There was also submitted to the Board the question whether certain capitalized sums expended by the respondent for drilling costs and development expense in connection with oil wells were returnable to respondent through a depletion or a depreciation allowance. (R. 113–115.) The Commissioner had treated such sums as subject only to a depletion allowance, but the Board held that they were subject to depreciation allowance.[2] (R. 120–123.)

[2] The Board's decision on this question is in accord with the decision of the Court of Claims in *Dakota-Montana Oil Co.* v. *United States*, 59 F. (2d) 853, in which the United States has filed a petition for certiorari, No. 434, October Term, 1932. The Board's decision is contrary to the decision in *Burnet* v. *Petroleum Exploration* (C. C. A. 4th), decided October 3, 1932, in which the taxpayers filed a petition for certiorari, No. 448, October Term, 1932. The petitions in those cases were granted November 14, 1932, and thus the precise question is already before this Court.

The respondent appealed from the portion of the Board's decision holding that its income derived from the oil lease on city lands was taxable, and the Commissioner appealed from the portion of the Board's decision allowing deduction of capitalized costs as depreciation. The Circuit Court of Appeals for the Ninth Circuit held that the tax assessed by the Commissioner could not constitutionally be imposed upon the income derived by the respondent from the sale of oil taken from the land leased by the city, and concluded that the assessment of the Commissioner should be set aside. Accordingly, the court did not pass upon the question presented by the Commissioner's appeal.

SPECIFICATIONS OF ERROR

The Circuit Court of Appeals erred:

1. In holding that the respondent's income derived from the sale of respondent's share of oil and gas produced under a lease of land owned by the city of Long Beach, California, could not be taxed by the United States.

2. In reversing the decision of the Board of Tax Appeals holding that such income was subject to Federal taxation.

3. In failing to hold that respondent's capitalized expenses for drilling oil wells were recoverable only through a depletion allowance.

4. In failing to hold that respondent's capitalized expenses for development of oil wells were recoverable only through a depletion allowance.

5. In reversing the determination of the Commissioner of Internal Revenue assessing a deficiency.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below involves a radical extension of the immunity of State instrumentalities from Federal taxation. Such immunity is extended in this case to the lessee of oil lands owned by a municipality which were not devoted to a governmental purpose, without proof that the royalties payable to the city under the provisions of the lease were to be devoted to any governmental purpose. The court below, quite erroneously we believe, considered the decisions of this Court in *Burnet* v. *Coronado Oil & Gas Company,* 285 U. S. 393, and *Gillespie* v. *Oklahoma,* 257 U. S. 501, as controlling. The extension of sovereign immunity from taxation to the income derived by private lessees from property leased by a municipal corporation, used by the lessees for private business purposes, may seriously impair the revenues of the Federal Government. We accordingly believe that the question presented is one of sufficient general importance to require review.

2. In reversing the determination of the Commissioner of Internal Revenue assessing a deficiency, the court below failed to correct the erroneous decision of the Board of Tax Appeals that certain capitalized expenses of the respondent for drilling and development of certain oil wells were

recoverable through depreciation. Under the applicable Revenue Acts and the regulations thereunder such expenses were recoverable only through depletion. This question is presented in *United States* v. *Dakota-Montana Oil Co.*, No. 434, October Term, 1932, now pending on writ of certiorari granted November 14, 1932, and *Petroleum Exploration* v. *Burnet*, No. 448, October Term, 1932, now pending on writ of certiorari granted November 14, 1932; and therefore the question should also be considered in this case.

Wherefore it is respectfully submitted that the petition should be granted.

THOMAS D. THACHER,
Solicitor General.

DECEMBER, 1932.

APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 254:

> SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.
>
> * * * * *

Sections 213 and 233 of the Revenue Act of 1924, c. 234, 43 Stat. 253, 267, 283 (U. S. C., Title 26, Secs. 954 and 985) contain provisions substantially the same as those of the corresponding sections of the 1921 Act above quoted.

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